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Flow-through dividends: practical questions 1/37/21

A Latvian company in a vertically structured group often receives dividends from subsidiaries and pays them on to its owners. Such flow-through dividends qualify for a special relief under the Corporate Income Tax (CIT) Act: if certain conditions are met those dividends are taxed only once even if tax has been paid abroad. In practice various situations may arise, for instance, a dividend is received and paid in different periods, the profit may not have been taxed in the payer's country, the Latvian company receives the dividend net, i.e. after tax has been withheld in the payer's country. This article explores some relevant examples.

Applying section 6 of the CIT Act

Section 6(1) of the CIT Act allows a taxpayer to reduce dividends included in the tax base for the tax period to the extent he has received dividends in the tax period from a dividend payer that pays CIT in his residence country or any dividends on which tax has been withheld at source other than dividends received from a person based, formed or incorporated in a blacklisted tax haven.

Section 6(2) of the CIT Act states that if the dividend received in the tax period under section 6(1) is greater than the dividend declared, the difference can be carried forward in chronological order and offset against dividends to be included in the tax base.

When are dividends treated as received under section 6?

Section 6(1) of the CIT Act treats dividends as received when the company has physically received them in its bank account.

For example, the minutes of a general meeting of shareholders relating to a dividend payment are dated 30 December 2020 but the dividend was physically remitted on 15 January 2021. The company booked dividend income in December 2020 but had not received it physically. Can this dividend be deducted from the tax base?

In this case dividends received on 15 January can be used to reduce the tax base as of January 2021 if the conditions of section 6 of the CIT Act and the Cabinet of Ministers' Rule No. 677 are met, including the company holding a certificate issued by the tax authority of the dividend payer's residence country or any other document (e.g. a tax payment order) confirming that the dividend payer is a resident of the other country who pays CIT in his residence country, or documentary evidence that tax has been withheld on the dividends.

If the Latvian company paid an extra dividend in December 2020, the dividend to be received next January cannot be deducted from the tax base when preparing the CIT return for December. Yet any dividends received in previous years can be deducted from the tax base (see below).

Can dividends received be allocated to other tax periods?

Dividends received from 2018 onwards that can be deducted from the tax base under section 6 of the CIT Act can be carried forward in chronological order indefinitely.

Line 2, *Dividends Received in the Tax Period and Taxed [..]*, on the CIT return contains a table to be completed for dividends received that can be deducted from the tax base generated by dividends. The table shows the tax period in which a dividend was received, details of the dividend payer, and the amount of dividend received. If the company does not pay a dividend in the tax period (does not complete line 1 of the CIT return) and cannot take this relief, the company should state that the dividend is allocated to future tax periods.

Accordingly, when completing CIT returns from 2018 onwards and stating all the dividends received in the table of line 2, the company can trace the dividends received and use them for tax base reduction purposes in chronological order.

Examples

Background	Can we reduce the tax base?
1. A dividend was received in 2020 out of a profit made in 2017.	Yes, dividends received in 2020 can be used to reduce the tax base even if they come from 2017 and earlier years. This is confirmed by the tax authority's advance tax rulings (e.g.). However, if the company received dividends also in 2018 and 2019 but has not used them for tax base reduction purposes, the tax base should be reduced by the dividends received in 2018 and 2019 before it can be reduced by the dividend received in 2020.
1. The CIT return for December 2020 is in preparation. A dividend was received in 2019 out of a profit made in 2018.	Yes, dividends received in previous periods can be deducted from the tax base generated by the profit distributed in the current period if those dividends have not yet been used to reduce the tax base and if the conditions of section 6 of the CIT Act are met.
1. A dividend is received from a member state's company that has not applied any nationally available CIT exemption to its profit.	It is assumed that CIT or PIT has been paid if a dividend or dividend equivalent is paid by a company registered in another EU/EEA country operating under its national law. This is confirmed by the tax authority's advance tax ruling.
1. In 2020 the Latvian company's subsidiary distributed a profit of EUR 10,000 on which a 5% tax was withheld abroad, so the Latvian company received EUR 9,500 net. The Latvian company also distributes a profit of EUR 20,000, including the dividend received from the subsidiary.	One might wonder how much the Latvian company can deduct from the tax base generated by dividends (EUR 10,000 or 9,500) and whether the foreign tax withheld can be offset against the Latvian CIT charge on the dividend declared. Since the Latvian company books EUR 10,000 of dividend income and EUR 500 of foreign tax paid, a flow-through profit of EUR 9,500 available for further distribution can be deducted from the tax base. Since the double taxation of dividend income is prevented under section 6 of the CIT Act, deducting the foreign withholding of EUR 500 would not make sense.